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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 137.

LOUIS ABRAHAM, ET AL., TRUSTEES OF THE JOE ABRAHAM ESTATE, *Petitioners*,

v.

HIDALGO COUNTY WATER CONTROL AND IMPROVEMENT DISTRICT NO. 1, ET AL., *Respondents*.

PETITION FOR REHEARING.

(Certiorari Denied October 12, 1942.)

CERTIFICATE OF COUNSEL.

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PETITION FOR REHEARING.

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PETITION FOR REHEARING.

(Certiorari Denied October 12, 1942.)

Petitioners, Louis Abraham, et al., Trustees of the Joe Abraham Estate, by their attorneys, respectfully petition for a rehearing of their petition for writ of certiorari duly filed herein, and thereafter denied by order entered on October 12, 1942:

For cause, as petitioners would respectfully show: The opinion below, upon its face, evidences misconceptions of facts and of law and fact, (a) that are sufficient to require declaration that the determination of the case is put upon the wrong ground so that it may not be followed as a proper precedent, (b) or misconceptions that conflict with settled precedents and confuse the application of recent remedial legislation for the relief of municipalities, or (c) misconceptions that are against the weight of the evidence.

STATEMENT.

The case below was begun in equity, in February, 1940, when a taxpayers' association sued the District and petitioners to cancel as void the certain non-negotiable note of the District delivered to petitioners, on August 13, 1937, as the agreed deferred consideration provided, in a written agreement of August 5, 1937, for a common law settlement upon an 80 per cent basis, of the legal liability of the District to petitioners as the holders of its certain bonds. Upon removal into the Federal district court, the case was realigned substantially into the cross claim of petitioners for recovery upon the note, as evidencing the legal refunding of an existing legal debt of the District, and the defenses of the District and association that the note was void as the result of a "simulated" transaction (R. 48, 49), and (R. 34) as being the creation of a new indebtedness of a municipality because not previously submitted to and approved by the voters of the District as required by the Constitution and statutes of Texas.[1]

The material facts stipulated by the parties are these:

On July 30, 1937, the petitioners legally owned and held (R. 84) legally issued (R. 78-83) District bonds and attached interest coupons on which the total District obligation to petitioners (R. 84) was $44,669.03; said bonds created an obligation (R. 96) upon the District to levy and collect a sufficient tax each year to service the same, which tax was to be placed in an interest and sinking fund to be used to discharge said bonds and interest coupons when and as accrued; the power of the District (R. 122) to levy advalorem taxes is unlimited as to rate if levied under the powers granted by the constitution and laws of Texas. In 1934 the Reconstruction Finance Corporation (hereafter, the R. F. C.) authorized a loan of not exceeding $902,500 to the District (R. 100) to refinance its indebtedness under a

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[1] Texas Constitution, Sec. 59, is an appendix to the petition. A (pp. 67-68)
Article 7880-147(u), Sec. 4 is an appendix herein.

plan (R. 124) for certain loan advancements in cash against principal claims to the creditors of the District upon their assent to the plan by sale and deposit in surrender of their claims or securities to the R. F. C. The securities surrendered remained in full effect (R. 131) subject to surrender to the District upon payment of the advancements and 4 per cent interest, or, at the option of the R. F. C. to be surrendered to the District in exchange for its certain new 4 per cent refunding bonds. No such new bonds (R. 122) have ever been issued to the R. F. C. The agreement provided the District should annually (R. 132) levy and collect taxes, assessments and other charges and pay them to the R. F. C. sufficiently to pay the principal and interest upon the original securities, unless the R. F. C. required only the payments of the amounts of principal and interest due upon the loan disbursements. Such levy and collection upon the old securities was made until January 1, 1936 (R. 97) and thereafter, with R. F. C. consent, only upon the basis of the loan disbursements.

Under the R. F. C. plan, and upon other terms, the District was undertaking to compose its obligations with its creditors (R. 94). The petitioners (R. 107) refused to accept the R. F. C. refunding plan or its cash offer, and threatened suit upon the overdue coupons.

On March 12, 1937, the District and petitioners made an agreement that was never consummated, (R. 85) to settle its obligation of $43,743.13, then existing (R. 109) for $37,-931.78 with a cash payment of $14,686.40 to be obtained by petitioner assent and surrender of its bonds under the R. F. C. plan, and by delivery of District 4 per cent refunding bonds for the balance.

On July 30, 1937, the District and petitioners finally agreed in writing to "settle and refund" (R. 86, par. 2) the then-existing obligation of $44,669.03, upon an 80 per cent basis for $35,735.22, to be consummated by the single mutual instruction put into the agreement (R. p. 93) that the designated State Bank should take and hold the bonds from petitioner in escrow for delivery back to petitioners (R. 88)

unless on or before August 15, 1937, the District, "has made available" (R. 88) to the escrow bank and the escrow bank has transmitted to petitioners the sum of $14,686.40 in cash and a specified note of the District (R. 94-5) for $21,048.82, in which event, petitioners would deliver the bonds through the escrow bank to the District. On August 13, 1937, (R. 94) the escrow bank delivered the cash and the note duly authorized by its Board of Directors of the District to petitioners. The note provided for its owners and holders to be (R. 12) "subrogated to all the rights, powers and privileges that they had as the owners of said bonds and coupons, in and to all delinquent taxes due the Interest and Sinking Fund created to secure the payment of said bonds and coupons, and also have, to secure this note, all rights they would have if still the owners and holders of said bonds and coupons attached."[2]

On August 5, 1937, when the bonds stood in escrow subject to the agreement, the District (R. 114) caused the State Bank, in disregard of the single escrow instruction immediately to send the bonds then belonging to petitioners, with documents, (R. 115), reciting absolute authority so to do, to the R. F. C. in surrender and for collection of the sum of $14,686.40, the cash payment under the R. F. C. plan. "*By such transmittal at* (R. 122) *the request of the District, R. F. C. came into possession of said bonds.*" On

[2] The findings of fact of the trial Court thus summarize the differences in the March and July agreements:

> "The principal differences between the contracts of March 12, 1937, and July 30, 1937, were these: Under the first contract specific reference was made to the Reconstruction Finance Corporation arrangement. The difference was to be paid to the Estate by the issuance of refunding bonds and the original bonds were to be forwarded by the McAllen bank to the Federal Reserve Bank of Dallas with draft attached and drawn upon Reconstruction Finance Corporation for the cash payment; whereas, under the second contract, all reference to Reconstruction Finance Corporation was omitted; no provision was made for sending the original bonds and coupons to the Federal Reserve Bank; and the difference was to be paid to the Estate by the execution of the note instead of refunding bonds."

August 13, 1937, the State Bank (R. 94) delivered said cash and the specified note of the District to petitioners. The District never made any levy (R. 96) on account of, nor any payment of principal or interest (R. 99) upon said note delivered to petitioners.

The material testimony is very brief and very certain:

Judge J. F. Carl, counsel for the District, testified (R. 247) the parties never considered the July agreement was a "simulated" transaction, and that he deemed same a valid transaction such as the parties wanted to make (R. 251), that, as its provision was merely for a note, the July agreement was not submitted to the R. F. C. (R. 250), that a District audit report in 1938 first advised the R. F. C. (R. 243) of the issue of the note, that the R. F. C. had approved the acquisition in surrender of bonds in other transactions at values above the R. F. C. unit price (R. 248-9). Mr. Joe Burns, District General Manager and Director, testified (R. 260, 267) the District used tax funds both with and without the consent of the R. F. C., in settling with non-consenting bondholders, and (R. 262) never advised the R. F. C. of the note or of the transaction with petitioners. Mr. L. Abraham, of petitioners, testified (R. 281) petitioners would not have delivered the bonds to the escrow bank if petitioners knew the bonds were to be transferred to the R. F. C., and that their attorney advised petitioners could not sell the bonds to the District and allow the District to resell them to the R. F. C., as thereby, any refunding of the balance would be illegal; and that Mr. J. E. Wilkins, counsel for petitioners, testified (R. 288-9) Judge Carl told him, in the rewritten agreement not to change the amount of the cash or note, as the District had agreed to the refund of the bonds, and to issue its refunding agreement when the bonds were turned over to the District, and that no one ever suggested a "simulated" transfer.

In June, 1940, after trial but before decision of the case, and pursuant to the federal statute for the relief of municipalities (Act Aug. 16, 1937 (c. 657), 50 St. 653; U. S. C.

A. Title II, 401-403) the District tendered to the District Court its petition in proposal of a composition (R. 316), upon the plan of the R. F. C. commitment, of the note of petitioners, without admitting its validity, and of several non-assenting bonds with recital that practically all its other creditors had assented to the proposed plan. The Court ordered the petition filed (R. 321) and stayed all other proceedings against the District and in reference to the plan (R. 325, 328) pending the final determination of this case. The Court later stayed the mandatory relief given by the Judgment herein pending final determination of the appeal.

Thereafter, the trial court, holding the note valid, entered judgment for recovery by petitioners thereon (R. 158) and for mandatory relief. It also (R. 161) filed its findings of fact and conclusions of law (R. 161) and its memorandum opinions upon the merits (R. 172) and overruling the motion of the District for a new trial (R. 175). The trial court also (R. 170) files its conclusion of law that if the note was unenforceable, nevertheless petitioners had an equitable right of recovery,[3] The appellate court, holding

[3] (Record, p. 170):

"If, under any construction, the note involved should be unenforceable, the Abraham Estate is nevertheless equitably entitled to recover for the difference between the cash payment made by the District and the face value of their bonds and coupons, subject, of course, to the right of Reconstruction Finance Corporation to a preference to such funds that are collected from the tax levy made to service its indebtedness, and which is necessary for such purpose. The Estate's right to such judgment for the difference between the cash payment made by the District and the face value of their bonds and coupons is established by the principles announced in Louisiana v. Wood, 102 U. S. 294, 26 L. Ed. 153; Geer v. School District No. 11 (C. C. A. 8), 111 Fed. 682; City of Parkersburg v. Brown, 106 U. S. 487, 1 Sup. Ct. 442. In such event the Abraham Estate is entitled to a mandamus to compel payment by the District out of such funds as it now has on hand or so much thereof as is available at the present time not already pledged, and is entitled to a mandamus to compel a tax levy sufficient to discharge the remainder thereof.

itself not bound (R. 359) in an equity case by the findings of fact, has substituted its own findings and conclusions, and reversed the trial court by holding the note void (R. 363). The pertinent appellate findings and conclusions are presented as error in the

ARGUMENT.

The appellate opinion upon its face, evidences misconceptions of facts and of law and fact (a) that are sufficient to require declaration that the determination of the case is put upon the wrong ground so that it may not be followed as a precedent, or (b) that conflict with settled precedents and confuse the application of recent remedial legislation for the relief of municipalities.

The first objection is submitted upon the authority of *Hurn* v. *Oursler*, 289 U. S. 238, 240, that:

> "* * * if the determination of the court was put upon the wrong ground we should so declare; that it may not be followed as a precedent."

The materially wrong ground herein is in each of two conclusions of the Court below, *first*, that petitioners sought and obtained an inequitable preference over other bondholders; *second*, that the pending composition conclusively measures the petitioners' right. Each ground thus taken is submitted in conflict with established precedents. Each is submitted to cloud, not clarify, recent state and federal laws for the relief of municipalities from financial embarrassments.

First.—The law is clear that, excepting where it is forbidden by a bankruptcy law, a vigilant creditor is entitled to the preference and its advantage over other creditors obtained by his attention to his own interests, (*Blennerhassett* v. *Sherman*, 105 U. S. 100, 117), and that a debtor in failing circumstances may so prefer his creditors though it lessen or absorb the fund for the payment of his other creditors (*Huntley* v. *Kingman & Co.*, 152 U. S. 527, 532).

The trial court noted this principle in holding the question of preference not material (R. 227, 249) while admitting evidence that the R. F. C. permitted special settlements from tax funds of non-assenting bonds.

As against petitioners, the charge of legal fraud (R. 250) is substantially upheld (R. 361) by the appellate opinion conclusion of unjustified inequality in the settlements with the non-assenting petitioners, and with the assenting bondholders. This contention is precisely measured and rejected in *Clark* v. *White*, 12 Peters 178, 199, thus:

> "The rule cutting off underhand agreements in cases of joint and general compositions, as a fraud upon the other compounding creditors, and because such agreements are subversive of sound morals and public policy, has no application to a case like the present; where each creditor acts not only for himself, but in opposition to every other creditor, all equally relying upon their vigilance to gain a priority; which, if obtained, each being entitled to have satisfaction, the payment cannot be questioned. The debtor may prefer one creditor, pay him fully, and exhaust his whole property, leaving nothing for others equally meritorious. Yet their case is not remedial: and why may not debts be partially paid in unequal amounts? If those who receive partial payments are willing to give releases, it is their own matter; and, should a third person interfere, debtor and creditor could well say to him, you are a stranger, and must stand aside."

These precedents entirely apply herein where the District could not avail itself of or petition the proposal for a composition until authorized by the act of August 16, 1937, (c. 657, 50 St. 653; U. S. C. A. Title 11-401-403), which was enacted after consummation of the July agreement. The prior Act of May 24, 1934 (C. 45, 48 St. 798; U. S. C. A. Title II, 301-303), extending relief by such proposal was declared unconstitutional in *Ashton* v. *Cameron County, etc.*, 298 U. S. 513, 299 U. S. 619 on May 25, 1936, before the agreement was made, and the District had never sought relief under its provisions.

These precedents apply because the composition available to a municipal corporation involves only such preferences as are within the plan proposal itself. Failure of the proposal or of the plan does not result in bankruptcy, for the ending is the dismissal of the proceeding. Here, there is no bankruptcy law that prevents the preference of a creditor by a municipality.

These precedents apply here where the bondholders, with the choice of assent and surrender to the R. F. C., or of non-consent and other arrangement with the District without regard for the R. F. C. plan, thus pursued their own interests in opposition to each other and to the R. F. C., that sought to become a creditor to the extent of its advancements.

The appellate opinion recites and approves a preference to the R. F. C. in its conclusion (R. 362) that the District pledged all future taxes to secure the refunding bonds, forgetting there are no refunding bonds issued and that their issue could not bind non-assenting holders until a plan involving them was judicially imposed on such holders in a proper composition proceeding.

The preference of petitioners appears as a probable breach of its R. F. C. contract, and against the issue of refunding bonds of the same class for uniform fixed payments (Cf. *Block* v. *City of West Palm Beach*, 112 F. (2) 949 (C. C. A.-5) citing *Clark* v. *White*, *supra*). The preference to petitioners intended (R. 107) petitioners should not sue for judgment upon interest coupons and obtain its mandatory enforcement (Cf. *United States* v. *Jones*, 94 F. (2) 320 (C. C. A.-5)) as a preferential claim. The actual breach by the District of its agreement with petitioners by procuring payment of the R. F. C. advancement notwithstanding the steadfast refusal of petitioners to resort to or to accept such advancement, stands out plainly. It cannot be said petitioners went into the R. F. C. contract of general composition, at the same time having an underhand agreement with the District for a larger per cent (Cf. *White* v. *Clark, supra*).

Second.—The trial court entirely ignored the composition plan proposal in deciding the case, while the appellate court draws conclusively upon it. It is submitted the appellate attitude conflicts with *American United M. L. Ins. Co.* v. *Avon Park,* 311 U. S. 138, holding the assent of the vast majority of creditors is not the single test, for the approval of the equality and fairness of a plan in a municipal composition, because thorough inquiry is necessary whether all material facts were disclosed when the assents were solicited and obtained. The tendered plan here is neither approved nor effective, and appellate decision wrongly rests upon a presumption that the plan will be approved. Such presumption cannot arise merely from a multitude of assents. Judicial action—not wishful thinking—effects approval of the plan for purposes of its application.

Within the legal limitations against unauthorized indebtedness, the Federal provisions for aid to municipalities and the state enabling statutes are intended to meet emergency situations not previously definable and requiring freedom of conduct in the municipal response. The appellate opinion recognizes the repose of the present transaction as within and as not exceeding the authorized legal indebtedness of the District, by holding (R. 361): "It is true the agreement * * * did not increase the old indebtedness." If the District may not for its advantage reduce the substance by change of the form of its legal obligation, which is the substance of the appellate conclusion, the several emergency relief provisions become futile.

In matching benefits obtained by municipalities against subsequent claims of invalidity of the resulting obligations because of constitutional and statutory limitations, the Courts look to the benefits and substance, not to the form. (*Hidalgo County Drainage District No. 1* v. *Creath,* 68 F. (2) 119, (C. C. A.-5). *Nueces County etc.* v. *Texas State Bank,* 67 S. W. 427.) The *Nueces* case is explained and quoted on pp. 41-43 of the petition. The appellate opinion

puts it aside by erroneous emphasis of the preferences and of the pledge of future taxes to the R. F. C. The trial court is submitted to have established fully the validity of the note herein.[4]

The misconceptions of fact in the opinion below are against the weight of evidence.

The appellate opinion contradicts the reliance of the trial court upon stipulated facts (R. 240) by its two conclusions that petitioners knew the District could borrow the cash payment only from the R. F. C. by deposit and surrender of the bonds because of their knowledge of the provisions of the R. F. C. agreement, and that such action extinguished the old bonds.

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[4] (Record, p. 205):

"Of course the transaction in question was not a statutory refunding as generally contemplated by Texas laws (Art. 7880-92, Vernon's Civil Statutes of the State of Texas, providing for the issuance of new bonds and cancellation of the old bonds by the State Comptroller and registration of new bonds); however, under an act of the Texas Legislature in 1934 (Acts 1934, 43rd Leg., 2 C. S. p. 10, ch. 4, now Art. 7880-147 (u), Sec. 4), authorizing water control improvement districts of this type to borrow money from government agencies, broad powers are given for the making of refunding contracts with the holders of bonded indebtedness. True, the statute seems to contemplate the issuance of refunding bonds for the whole of such indebtedness and expressly authorizes an 'agreement with said District under the terms of which all or part of the uncollected taxes theretofore levied by said District for the payment, or part, of the outstanding indebtedness of said District, shall, when collected, be paid into a separate interest and sinking fund created for the sole purpose of paying interest on and principal of the bonds held by such holder'. There is nothing in this statute to indicate that the bonds to be paid in that manner should not be represented in some other form of indebtedness; and it is also significant that the note sued upon by the District contains a special provision giving the holder of the note all rights 'in and to all delinquent taxes due the interest and sinking fund created to secure this note' which they would have had if they were still the owners of the bonds and coupons."

The stipulated facts *(supra)* are that the District and petitioners reached an agreement that entirely refused to recognize the R. F. C. as a party; that the District deliberately violated its covenant that the escrow bank should hold the bonds from delivery to the District, and thereby from its user, until the District "made available" the cash payment, and, by its violation provided the cash by unauthorized surrender of the bonds to the R. F. C. The uncontradicted evidence is the petitioners and District made their agreement as in good faith, and that its violation was not disclosed to petitioners or to the R. F. C. The stipulated fact *(supra)* is also that the surrendered bonds remained in full effect until replaced by refunding bonds, meaning their surrender has neither extinguished them nor scaled down the District debt pending the issue of refunding bonds. This disposes of the next conclusion of the appellate opinion that the bonds were actually scaled down to $902,500. Such scaling, cannot be the result of a commitment, with its purpose yet unrealized and not made effective by its judicial approval and application as a plan of composition.

The further conclusion that delinquent taxes and future taxes were pledged conclusively with the R. F. C. to the retirement of refunding bonds relates to the replacement of outstanding securities by refunding bonds—a situation yet to arise. It overlooks the interval duty of the District to levy and collect taxes for service of the original bonds, whether surrendered or outstanding, until refunding bonds replaced them, and to withhold the part thereof in excess of service charges payable upon the R. F. C. disbursements. This potentially provided the District with funds to settle outstanding bonds. It rebuts the further opinion finding that the old bonds were valueless unless the R. F. C. agreement was consummated.

The appellate opinion explicitly holds (R. 361): *"The agreement between the District and Trustees did not increase the old indebtedness"*, and then contradicts this by holding (R. 362): *"The giving of the note created a new debt and increased the indebtedness in the amount of the note"*—an apparent confusion of the ultimate fact.

Revision in an equity case, of findings of fact, that are against the weight of evidence, is upheld lately in *Morley Const. Co.* v. *Maryland Cas. Co.*, 300 U. S. 185, 191, in confirmation of the established precedents therefor.

CONCLUSION.

Petitioners, knowing the District proposed to make the R. F. C. its creditor in the amount of its loan advancements as cash settlements to bondholders assenting to its terms and to the surrender of their bonds, and knowing the District could prefer a creditor, refused to contract for any settlement of their bond claim by the District that involved the R. F. C. as a party. Petitioners elected to contract with the District alone to "settle and refund" its bonds in an amount that exceeded the R. F. C. proposal, but was to the advantage of the District and its taxpayers as less than its authorized debt owed to petitioners. They agreed petitioners should have in cash the same amount that a surrender of the bonds to the R. F. C. would afford, and should have something more. But the parties expressly contracted the bonds should not pass from petitioners through the bank and to the District until the District had "made available" the agreed cash payment, and specified deferred secured obligation and the bank had delivered same to petitioners. The District boldly violates its own contract and seeks to impose the R. F. C. payment as the legal limit of the settlement with them. It is submitted, in such case, that the appellate decision upholding the District, deserves

review by grant of the writ of certiorari upon this rehearing.

Respectfully submitted,

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CERTIFICATE OF COUNSEL.

The undersigned, of counsel, and attorney for petitioners, respectfully certifies the foregoing petition for rehearing is presented in good faith and not for delay.

Respectfully,

Camden R. McAtee,
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